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IN THE MATTER OF THE COMPETITION IN THE PROVISIONS OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. RE-00000C-94-0165

NOTICE OF FILING

Citizens Utilities Company hereby provides Notice of Filing Direct Testimony in regard to Stranded Cost Issues for Sean R. Breen in the above-referenced docket.

RESPECTFULLY SUBMITTED this 19th day of March, 1999.

Arizona Corporation Commission
DOCKETED
MAR 19 1999
DOCKETED BY

Craig A. Marks

Craig A. Marks
Associate General Counsel
Citizens Utilities Company
2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012

Original and ten copies filed this
19th day of March, 1999, with:

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All parties indicated on service list.

By: Joann Zychlewicz
Joann Zychlewicz

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Q. Please state your name and business address.

A. My name is Sean R. Breen. I am employed as a Project Manager by Citizens Utilities Company, 1300 South Yale Street, Flagstaff, Arizona.

Q. Are you the same Sean R. Breen who testified previously in this docket.

A. Yes, I am. My relevant experience and qualifications have been set forth in testimony filed January 9, 1998, in this docket.

Q. What is the purpose of your testimony?

A. My testimony addresses Citizens Utilities Company's ("Citizens") stranded costs attributable to the introduction of competition to the electric industry in Arizona and Citizens' unbundled rates created to enable electric competition to begin in its service area. My testimony updates Citizens' stranded costs and unbundled rates filings made August 21, 1998, and December 31, 1997, respectively.

Q. How is your testimony organized?

A. My testimony is comprised of two main sections. The first section deals with stranded costs and addresses the key subject areas of: stranded cost mitigation; generation-related stranded costs; regulatory assets; metering and billing-related stranded costs; transition costs; and the design of Citizens' stranded cost recovery mechanism, or so-called competitive transition charge ("CTC"). The second section of my testimony describes Citizens' unbundled rates and the terms of a settlement previously reached with Staff and RUCO on the implementation of these rates.

Q. Please summarize your testimony.

A. My testimony first describes the results of Citizens' stranded cost mitigation efforts, which have reduced projected generation-related stranded costs by nearly $29 million. As a result of these efforts, Citizens estimates that total stranded costs have been reduced from $57 million to $28 million, a 51%reduction.

1. Concerning generation-related stranded costs, I describe a proposal by Citizens to delay the divestiture of its APS power supply contract for approximately six months, implement a net lost revenues recovery mechanism for stranded costs in the interim, and make a filing with the Commission in mid-2000 for a final determination of whether divestiture is the best option for Citizens.
2. Concerning other components of stranded cost (regulatory assets, metering and billing, and transition costs), Citizens' estimates have not changed from its August 1998 filing. Citizens does propose, however, to establish two deferral accounts to capture and track transition costs and stranded costs associated with opening metering and billing to competition.
3. My testimony also describes proposals for slight modifications to the recovery mechanism proposed in Citizens' August 1998 filing to accommodate subsequent changes in the Competition Rules and the proposed changes in handling APS-contract stranded costs.
4. Finally, my testimony requests that the Commission approve the implementation of Citizens' unbundled rates consistent with the settlement previously reached with Staff and RUCO.

STRANDED COSTS

Mitigation

Q. Has Citizens undertaken efforts to mitigate its potential stranded costs?

A. Yes, it has. During much of 1998 and continuing into 1999, Citizens has focused extensively on mitigating the key components of its stranded cost, mainly in the areas of electric generation.

Q. Have these efforts been successful?

A. Yes, they have. In its August 1998 filing, Citizens identified and estimated $47.4 million of generation-related stranded costs associated with its power service contract with Arizona Public Service Company ("APS"), and its planned combustion turbine and transmission facilities in Mohave County. As a result of Citizens' mitigation efforts, these potentially stranded costs have been reduced by over 60%, a decrease of approximately $29 million.

Q. Please describe how and to what degree Citizens has mitigated stranded costs associated with the APS contract.

A. Citizens has recently negotiated substantial reductions to its long-term wholesale power supply agreement with APS. These reductions have reduced the estimated stranded cost potential of this agreement from $43.2 million to $18.3 million, a 57% reduction. In addition, the results of the negotiation translate into immediate reductions in generation costs of approximately 6% for existing (Standard Offer) customers. Moreover, such customers will see additional generation cost reductions in 2000 and 2001 respectively, as a result of modifications to the APS agreement. In total between now and April 30, 2002, Citizens' generation customers will realize nearly $13 million of savings.

Q. Was the negotiation process a costly undertaking?

A. No. Citizens has successfully re-negotiated this agreement without resorting to a costly and time-consuming filing with the Federal Energy Regulatory Commission ("FERC"). Citizens previously estimated the cost of a FERC filing, for outside services alone, to be $175,000. While a final accounting has not been completed, Citizens believes the total costs to renegotiate the contract, including all internal expenses, to have been less than $100,000.

Q. Why is a 57% reduction a reasonable level of mitigation of the stranded costs associated with the APS contract?

A. Citizens believes that the final result of the negotiation process reflects, on balance, the highest level of concessions in contract price and terms that could reasonably be expected under the circumstances. During the negotiation process, Citizens estimated, from publicly available information and data provided by APS, the embedded cost of the wholesale power services provided under Service Schedule A, that portion of the APS contract under negotiation. After extensive negotiations spanning a 10-month period, APS agreed to lower its rates under Schedule A to a level very close to Citizens' embedded cost estimate, and to do so retroactively back to November 1998. If Citizens had pursued a filing with FERC on this matter and received a favorable ruling, it does not believe that a result lower than APS' embedded costs could have been achieved for Schedule A rates. Furthermore, the retroactivity of the final rates would have applied only to a period beginning two months after the FERC filing was made – an estimated eight months beyond the negotiated retroactive date. Taking into account the avoided litigation costs, uncertainty, and time requirements of a FERC proceeding, Citizens regards this as a very favorable outcome.

Q. Did the negotiation process result in any other important concessions for Citizens?

A. Yes, there are two additional important concessions resulting from the negotiation process. First, APS agreed to modify the contract to make it fully assignable to a third party by January 1, 2001, the date when full competition in generation is slated to begin. This is important because it makes the contract clearly marketable and removes any uncertainty surrounding Citizens' ability to divest itself of the contract as part of its proposed stranded cost valuation and recovery process. Second, APS agreed to maintain the current contract pricing under Service Schedule B, a significant intermediate electric resource provided under the APS contract. This is an important concession because, under current contract terms, the cancellation of the Mohave CT (a matter I address below) would have caused the demand rate under Schedule B to increase by $2/kW-Month. Such an increase would have immediately raised power supply costs by over $1.2 million per year. Due to this concession, such increase will not occur.

Q. In what other way has Citizens mitigated its stranded costs?

A. Citizens has successfully eliminated the stranded cost exposure that would have resulted by canceling the 75-MW Mohave Combustion Turbine project ("Mohave CT"). Citizens and APS had contracted for APS to build this project and sell its output to Citizens. In its August 1998 filing, Citizens proposed to terminate the Mohave CT project to reduce its stranded cost exposure. By doing so, an estimated $1.85 million of cancellation costs and $2.1 million of expenditures for planning, permitting, and right-of-way costs associated with transmission facilities would have become stranded.

In the fall of 1998, Citizens entered a sales agreement with the developers of the Griffith Energy project, a 650 MW generation facility and related transmission improvements in Mohave County, in which Citizens transferred rights-of-way and environmental permits associated with a portion of the planned transmission corridor for a payment which significantly offset Citizens' stranded cost. Citizens retained its interest in the remainder of the corridor, which it plans to use for future transmission projects to meet the energy delivery needs of its customers.

Recently, APS elected to retain the combustion turbine for its own use thereby waiving any cancellation costs. Together, these events have effectively mitigated all potential stranded costs associated with the Mohave CT, for a total reduction in stranded costs of approximately $4 million.

Generation-Related Stranded Costs

Q. Please summarize the components of Citizens' generation-related stranded costs.

A. As set forth in its August 1998 filing, Citizens' generation-related stranded costs were comprised of two key components: the APS contract and the Mohave CT and associated transmission. As described above, the Mohave CT stranded costs have been reduced to zero and the APS contract stranded costs reduced to an estimated $18.3 million.

Q. Does Citizens continue to support divestiture of the APS contract as the means to value and recover its associated stranded costs?

A. Yes. However, Citizens is now proposing a slightly different approach to the divestiture process than set forth in its August 1998 filing.

Q. Please explain.

A. Citizens' August 1998 filing described a divestiture scenario that commenced a bid process at the beginning of the year 2000, with an ultimate assignment of the contract rights to the winning bidder by December 31, 2000. While Citizens continues to believe the end of the year 2000 as the most appropriate time for potential assignment of the contract, it now proposes to move the bidding into the second-half of 2000 to allow time to seek final approval from the Commission before proceeding with the bid process. Before accepting bids, Citizens would make a filing (in early to mid 2000) that seeks direction and approval on whether the Commission believes the Company should divest the contract or continue to hold it as a power source for meeting the load requirements of Standard Offer customers. This approach would provide the Commission with better information than that which exists today in order to judge whether Citizens' contract is sufficiently above market price to justify both the expense of divestiture as well as the risk that such divestiture could conceivably lead to even higher stranded costs.

Q. Why is this proposal being made now and not when Citizens made its original August 1998 filing?

A. Before knowing the results of its contract re-negotiations that made substantial reductions in the rates charged, Citizens did not have a reasonable basis for determining whether the APS contract would be within proximity of market price for many years. Now that contract rates are lower and the prospect exists that it may not create significant stranded costs, Citizens believes it is sensible to delay the decision to divest the contract for as long as practical. This way, the Commission will be in a better position to make a fair determination on the best course of action for Citizens.

Q. If Citizens maintained the APS contract to serve Standard Offer load, would that in fact be contrary to the provision currently in the Competition Rules that Affected Utilities acquire power to serve Standard Offer customers through an open bid process?

A. Yes, technically it would. However, Citizens believes, under the circumstances described, that the Commission may want to consider granting Citizens a waiver of that requirement.

Q. Why is that so?

A. If the determination is made in mid-2000 that the APS contract does not appear to present significant stranded cost potential, it may be prudent to allow Citizens to continue holding the contract, rather than having its customers incur the cost and risk of divestiture.

Q. Does Citizens continue to support its Enhanced Divestiture proposal?

A. Yes, it does. However, since this option also involves divestiture of the APS contract, Citizens proposes that, if approved, this be addressed using this modified approach, where final Commission approval is sought before proceeding.

Q. Are there any other changes with regard to the handling of the APS contract that Citizens proposes to make?

A. Yes. Citizens' August 1998 filing proposed that the Company notify APS as of January 1, 1999 of its intent to cancel Schedules B and C power deliveries (intermediate and peaking electric resources, respectively) by January 1, 2001. Given the uncertainty surrounding the timing of implementation of electric competition, Citizens did not exercise that option. In view of Citizens' current proposal here to possibly extend the contract beyond 2001, cancellation of Schedules B and C is not warranted at this time.

Q. Does extension of Schedules B and C of the APS contract beyond 2001 increase Citizens' stranded costs?

A. No. Schedules B and C are load-following schedules and therefore the associated costs are not likely to become stranded as Citizens' customers opt to take competitive power.

Q. Does Citizens propose any different treatment for its Valencia generation facilities than set forth in its August 1998 stranded cost filing?

A. No. Citizens continues to believe that the best interests of its customers are served by retaining the Valencia facilities as Must-Run generation and recovering their costs through unbundled Transmission service charges, as reflected in Citizens' unbundled rates filing.

Q. Are there any additional generation-related stranded costs?

A. Yes, there are two additional items. First, Citizens estimated its cost of divestiture of the APS contract to be $100,000 for consulting assistance.

Citizens continues to believe this to be a reasonable estimate. Second, Citizens included in its previous filing a "placeholder" estimate for the effects on stranded costs of dissolving its Purchased Power and Fuel Adjustment Clause ("PPFAC"), should that occur. Due to the substantial uncertainty surrounding this matter, Citizens has removed this item (which had a $1 million downward effect on the total) from its present stranded cost estimate.

Regulatory Assets

Q. Please summarize Citizens' stranded costs associated with Regulatory Assets.

A. In its August 1998 filing, Citizens reported approximately $3.0 million of regulatory assets that would become stranded by the implementation of competition. This amount represents the then-current balance of previously-deferred and unrecovered DSM and DSM lost revenues.

Q. Is Citizens proposing to change or update these stranded costs?

A. No, not at this time. However, at the time of its compliance filing in this proceeding, Citizens proposes that it update the balance of these regulatory assets to properly reflect carrying charges and the effect of related deferred income taxes on previous expenditures.

Metering and Billing

Q. Please summarize Citizens' metering and billing stranded costs.

A. In its August 1998 filing, Citizens estimated stranded costs of $1.1 million (net present value over 10 years) associated with metering and billing functions, based on a net-revenues-lost approach.

Q. Is Citizens proposing to change or update its metering and billing stranded cost estimate?

A. Conceptually, Citizens continues to support the method for determining metering and billing stranded cost presented in its August 1998 filing. My testimony provides greater specificity with respect to how Citizens proposes to calculate stranded metering and billing costs.

Q. Please describe Citizens' proposed method for calculating stranded metering and billing costs.

A. The introduction of competition for metering and billing creates stranded costs because certain costs associated with these functions (such as allocated Administrative and General costs) are not immediately reduced when customers take competitive services. As noted in Citizens' August 1998 filing, stranded costs associated with the metering and meter reading functions are relatively small since a majority of costs are variable and the meters, once removed, can technically be re-used to serve new customers. However, in the case of billing and collections, the majority of associated costs are fixed, and therefore, will not decline when customers opt for alternative service providers. Therefore, most of billing and collections costs are in fact strandable.

Q. How does Citizens propose to calculate these stranded costs?

A. The stranded costs for metering and billing would be calculated as the difference between lost revenues and the variable costs for customers who opt to take service from competitive providers. Lost revenues for the relevant services are calculated using the unbundled rate charges in Citizens' then-current tariffs. These charges are the average costs for these services, as determined in Citizens' most recent rate case, and include both fixed and variable components. Citizens proposes that the variable component be calculated as:

- all fully loaded labor costs;
- all per-unit priced subcontracted services such as meter reading;
- transportation costs; and
- meter investments (including property taxes, depreciation, return, and income taxes).

The remaining costs are fixed and therefore stranded when customers take competitive service.

Q. What accounting mechanism does Citizens propose for stranded metering and billing costs?

A. Citizens proposes to establish a Metering and Billing Deferral Account ("MBDA") for each of its rate classes to provide a mechanism for proper accumulation, tracking, as well as future analysis of the associated stranded costs for cost recovery evaluation purposes.

Q. How will accounting entries into the MBDA s be determined?

A. Citizens proposes that accounting entries into the MBDAs be made quarterly to allow an adequate period for calculating representative average costs. The calculation procedure would follow the following 6 steps for each quarter:

1. Calculate the total variable cost separately for metering (labor only), meter reading, and billing/collections using the above cost categories for each function.

2. Compute an average unit (per customer or per meter, as relevant) monthly cost for metering, (labor only), meter reading, and billing/collections based on the total number of customers-months in the period.
3. Because meter investment costs are highly dependent on customer rate classification, calculate an average meter investment cost separately for each rate class.
4. Calculate, by rate class, the difference between the relevant tariff charge and the average monthly variable costs, determined in the above steps, for each function.
5. Calculate the average number of customers taking competitive services during the quarter for each rate class.
6. For each rate class and function, multiply the difference determined in Step 4 by the number of customers determined in Step 5. This product is the stranded cost entry to the MBDA.

Q. Would any additional costs be included in the MBDAs?

A. Yes. Citizens proposes that it be allowed to include carrying charges based on its approved rate for Allowance for Funds Used During Construction ("AFUDC").

Q. How would the deferred costs in the MBDA ultimately be paid by customers?

A. Citizens proposes that it amortize the costs in the MBDAs through the CTC mechanism to be established in this docket.

Q. For how long does Citizens propose it be allowed to continue recovery of metering and billing stranded costs?

A. Citizens proposes to continue recovery of these stranded costs for a ten-year transition period.

Transition Costs

Q. Does Citizens anticipate transition costs associated with electric competition?

A. Yes. Citizens' August 1998 filing describes substantial expected transition costs under the heading "New Functions Under Competition." Such transition costs fall into the areas of: energy supply and demand transactions; new operational processes; regulation; and customer communication and education.

Q. Is Citizens proposing to update or change its filing relative to transition costs?

A. Citizens does not propose to update the basic structure of its proposal with regard to such transition costs, which is to establish a deferral account for future regulatory analysis and cost recovery purposes. Citizens would, however, like to incorporate its October 21, 1998, amendment to its August 1998 stranded cost filing that requested issuance of an accounting order. The October amendment asked that Citizens be allowed to:

1. establish a Competitive Transition Deferral Account ("CTDA") to accumulate the "New-Function Costs" described in its Stranded Cost filing;
2. make retroactive adjustments to its books to transfer legitimate transition costs incurred in 1998 and 1999 to the CTDA;

3. accumulate interest expense based on the unamortized balance in the CTDA using Citizens' currently-approved AFUDC rate; and
4. amortize the deferred costs in the CTDA, subject to the Commission approval of the process set forth in Citizens' August 1998 filing, through the Citizens' CTC to be established in this docket.

Q. Is Citizens proposing that the process described above to treat transition costs continue indefinitely?

A. No. The above process would apply only during the initial stages of electric competition. Once a more stable process for the functions to support open access has been established, it is reasonable to include the incremental costs for these activities as a part of Citizens' basic service rates. It would therefore be Citizens' intent to reflect the on-going level of these costs in the cost-of-service in the Company's next general rate case.

Q. Does Citizens have an updated estimate for its transition costs?

A. No. Citizens continues to believe the estimates included in its August 1998 filing to be reasonable. In that filing, Citizens estimated transition costs to include approximately $1.8 million of one-time costs and an on-going, average annual cost level of approximately $600,000.

Q. Is Citizens seeking approval for recovery of those amounts in this proceeding?

A. No. Citizens seeks only to establish the CTDA to accumulate prudent transition expenditures and to define the procedures for their subsequent recovery.

Stranded Cost Recovery Mechanism

Q. Please summarize Citizens' proposed stranded cost recovery mechanism from its August 1998 filing.

A. Citizens proposed a four-step stranded cost recovery process:

1. The Commission approves stranded cost amounts and/or calculation and accounting procedures for stranded costs expected to be incurred in future periods;
2. A CTC is established for each rate class based on an initial forecast of costs and the number of billing units that are expected to convert to open access;
3. Moving forward into competition, actual costs, billing units, and CTC revenues are tracked;
4. Periodically, in a proceeding before the Commission, these quantities are reconciled against the forecasted values and a new CTC is established based on historical actuals and updated forecasts.

This process would be applied to the four categories of stranded costs identified by Citizens: generation; regulatory assets; metering and billing; and transition costs.

Q. Is Citizens proposing any changes to this process?

A. Citizens is modifying its original proposal to accommodate two factors: 1) changes made to the Competition Rules that affect the CTC calculation; and 2) the proposed changes in handling of the stranded costs associated with the APS contract, including an interim CTC for the period from the initiation of competition until the disposition of the APS contract is determined (presumably in late 2000). In Citizens' original proposal, stranded costs for the APS contract would have been determined with finality through divestiture and subsequently amortized over a ten-year period. Since divestiture is uncertain under the current proposal, Citizens would establish a net-revenues-lost recovery mechanism at the start of competition and transition to its originally proposed recovery process if divestiture was determined by the Commission to be the best alternative.

Q. What contemplated changes to the Competition Rules would affect Citizens' stranded cost recovery mechanism?

A. The Competition Rules in place at the time of Citizens' August 1998 filing limited recovery of stranded costs to customers taking competitive service. Under the current draft of the Rules, stranded costs may be recovered from all customers taking distribution service. While this change would not require conceptual change in Citizens' proposed mechanism, it does change the calculation methodology. Where appropriate, Citizens would base calculations on total sales rather than competitive sales in computing CTC values.

Q. Can you be more specific about the handling of each of the four components of stranded costs?

A. The components of Citizens' stranded costs have both one-time and on-going elements. The table below illustrates the breakdown based on current estimates:

Stranded Cost Component	***One-Time Costs***	***On-Going Costs***
APS Contract	$18.4 million (if divested).	Lost Rev. minus Avoided Cost. (Interim CTC)
Regulatory Assets	$3.0 million	None.
Metering & Billing	None.	Lost Rev. minus Avoided Cost
Transition Costs	$1.8 million	Incremental Costs (~$600k/yr)

For calculation of the CTC, Citizens proposes that one-time costs be amortized over a ten-year period while annual on-going costs be recovered ratably throughout the year.

Q. Please explain the proposed methodology to calculate the CTC.

A. Citizens proposes the calculation of the CTC be made using the following steps:

1. Forecast revenue requirements for Commission-approved one-time costs (amortized over 10 years) and on-going costs for the up-coming period;
2. Allocate stranded cost revenue requirements to rate classes in a manner that reflects cost allocations underlying current rates;
3. Forecast total customer billing units for the up-coming period for each rate class;
4. Determine the CTC for each rate class as the quotient of the allocated revenue requirements and the total billing units for the period.

Q. Does Citizens propose to update the CTC periodically?

A. Yes. As explained in Citizens' August 1998 filing, the Company proposes that its CTC be updated annually during the initial years of competition and once every two years thereafter, as determined by the Commission. Through this process actual stranded costs and CTC revenues would be compared for the prior period and updated forecasts would be made for the upcoming period. A new CTC would then be calculated based on the needed true-ups from the prior period and the updated forecasts. It is anticipated that these calculations would be reviewed in a proceeding before the Commission.

Q. Does Citizens continue to support its proposals in its August 1998 filing relative to the rate design of the CTC?

A. Yes, it does. Citizens continues to firmly believe that stranded recovery charges, a function of past industry decisions and structures, should be based on historical usage levels and not be tied to future electricity consumption. Citizens continues to support a CTC rate design that employs flat monthly fees rather than volumetric-based charges.

Q. How would the interim CTC be calculated relative to the APS contract, the largest component of Citizens' stranded costs?

A. Stranded costs under the APS contract can be calculated as the difference between the change in revenue and the change in power supply cost that occurs when customers leave the Citizens' system. When a customer's load is lost to alternative power suppliers, generation revenues are decreased at a rate approximately equal to Citizens' average power supply costs. At the same time, Citizens' power supply costs are reduced at a rate equal to its short-run decremental (or avoided) cost. Since Citizens' avoided supply costs are lower than its average power costs, each kWh lost creates lost net revenue or stranded cost.

Q. What is the magnitude of these stranded costs?

A. While the actual amount of stranded cost depends on the load characteristics and existing rate class of the customers leaving the system, Citizens expects these costs to range between $.01 - $.02/kWh for departing commercial customers and be approximately $.02/kWh for departing residential customers.

Q. Does this mean that rates for residential customers taking competitive service, for instance, will be the equivalent of $.02/kWh higher to pay for Citizens' stranded costs?

A. No, this would not be the case assuming the current provision in the competition rules is retained that allows all distribution customers to pay a competitive transition charge. With this provision retained, stranded costs would be spread across all customers resulting in a stranded generation charge would be some fraction of the amounts cited, based on the percentage of sales that are from alternative sources.

Q. Why isn't the market price for power factored into Citizens' stranded cost calculation?

A. If Citizens were in a position to re-sell the power resources freed up when customers take competitive service, the market price would be a factor in stranded cost calculations. However, Citizens is not in this position since its APS contract applies only to power consumed by Citizens' customers; no provision is available to Citizens to sell any power outside its service area.

Q. Would the other components: regulatory assets, metering and billing, and transition costs also be included in the interim CTC?

A. Yes. Citizens refers to this mechanism as "interim," in that it would precede the final decision on the disposition of the APS contract, the single largest component of stranded costs.

Q. What approvals does Citizens seek from the Commission in this filing relative to stranded costs?

A. Citizens seeks approval for:

1. the recovery of APS contract stranded costs using, in the interim, the net-revenues-lost method for calculation described here;
2. the recovery of the Regulatory Assets of approximately $3.0 million comprised of previously deferred DSM costs and lost net revenues;
3. the establishment of Metering and Billing Deferral Accounts for recovery of related stranded costs;
4. the establishment of a Competitive Transition Deferral Account for recovery of transition costs for enabling competition in Citizens' service area including the ability to make retroactive adjustments to its books to transfer legitimate transition costs incurred in 1998 and 1999;
5. the establishment of and calculation methodology for the proposed CTC mechanism, including flow-through accounting and Commission-approval procedures summarized in my testimony; and
6. Citizens' proposal to delay APS contract divestiture with final determination on the ultimate disposition of the contract made on the basis of a mid-year 2000 filing by Citizens.

Q. How would Citizens likely proceed if given the above approvals?

A. Following approval of these matters by the Commission, Citizens would: establish the approved deferral accounts; prepare and file a final accounting of its previously-incurred expenditures; and file a proposed initial CTC based on the approved stranded costs and calculation methodology.

UNBUNDLED RATES

Q. Did Citizens negotiate a settlement of its unbundled rates filing with Staff and RUCO?

A. Yes, it did. A document summarizing this settlement, the December 22, 1998 Commission Staff's transmittal memorandum and proposed order on Citizens' unbundled and standard offer service tariffs filing (Docket No. E-01032C-97-0774), is attached to my testimony as Exhibit A.

Q. Please summarize the elements of the settlement.

A. Under the settlement, Citizens would initially implement standard offer and unbundled rates that are essentially revenue-neutral. Later this year, Citizens would file a rate design proposal for consideration by the Commission that is based on more current load and usage data and incorporates a number of principles set forth in the settlement document.

Q. Does Citizens continue to support the rate settlement?

A. Yes, it does. The settlement was based on lengthy discussions between the parties in 1998 and is a reasoned resolution of the issues and a sound basis for the establishment of Citizens' rates for supporting electric competition.

Q. What does Citizens propose that the Commission do with respect to the settlement?

A. Citizens respectfully requests that the Commission approve the settlement in its present form.

Q. Does this conclude your testimony?

A. Yes, it does.

EXHIBIT A

JIM IRVIN
COMMISSIONER-CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

JACK ROSE
EXECUTIVE SECRETARY

ARIZONA CORPORATION COMMISSION

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PHOENIX ADM. OFFICE

December 22, 1998

Mr. Craig A. Marks
Associate General Counsel
Citizens Utilities Company
2901 North Central Avenue, Suite 1660
Phoenix, Arizona 85012

Dear Mr. Marks:

Enclosed are the Commission Staff's transmittal memorandum and proposed order on the Citizens Utilities Company's unbundled and standard offer service tariffs filing (Docket No. E-01032C-97-0774). This is only a Staff recommendation to the Commission; it has not yet become an order of the Commission. The Commission can decide to accept, amend or reject Staff's proposed order.

This matter is scheduled for Commission deliberation at its Working Session on December 30, 1998, at 10:00 a.m., and for a Commission decision at either its Working Session on December 30, 1998, at 10:00 a.m., or at its regular Open Meeting on December 31, 1998, at 10:00 a.m.

If you have any questions about this matter, please contact John Wallace of our Staff at (602) 542-0865, or me, at (602) 542-0748.

Sincerely,

Ray T. Williamson

Ray T. Williamson
Acting Director
Utilities Division

RTW:JVW:djg/PAB

Enclosure

MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: December 22, 1998

RE: IN THE MATTER OF THE FILING BY CITIZENS UTILITIES COMPANY OF UNBUNDLED AND STANDARD OFFER SERVICE TARIFFS PURSUANT TO A.A.C. R14-2-1606 (DOCKET NO. E-01032C-97-0774)

On December 31, 1997, Citizens Utilities Company (Citizens, CUC or Company) filed its unbundled and standard offer service tariffs pursuant to A.A.C. R14-2-1606. In this filing, the Company priced electric service elements such as transmission and distribution. The Company filed standard offer tariffs, which increase, decrease, and change rates for various customer classes (residential, small general, etc.). CUC also submitted information and requested a system benefits charge.

Effective December 26, 1996, the Arizona Corporation Commission (Commission) adopted rules governing the parameters of retail electric competition. Pursuant to A.A.C. R14-2-1606(D), each incumbent utility must file Unbundled Service Tariffs to provide the following services to all eligible purchasers on a nondiscriminatory basis: Distribution service; Meter and meter reading service; Billing and collection service; Open access transmission service; Ancillary services; Information services; and Other ancillary services necessary for safe and reliable system operation. Pursuant to A.A.C. R14-2-1606(C), each incumbent utility may also file proposed tariffs to provide standard offer bundled service.

Decision No. 60575, dated January 14, 1998, suspended this filing until May 29, 1998. Decision No. 60910, dated May 22, 1998, suspended this filing until November 25, 1998. In a letter dated November 13, 1998, the Company agreed to delay the implementation of its Unbundled Services Tariffs and System Benefits Charge, which were filed on December 31, 1997 until December 10, 1998.

Staff's concern with the Company's unbundled tariffs as filed on December 31, 1997 was that they would result in step increases and decreases for certain standard offer customers and customers who choose competitive suppliers. These increases and decreases were primarily the result of higher fixed charges in the unbundled and standard offer tariffs than are in the Company's current tariffs.

As a result of discussions with Staff the Company and Staff have developed a Summary of Settlement Terms (Settlement Terms) dated November 30, 1998. The major provisions of those Settlement Terms are detailed below.

For 1999, Citizens' unbundled and standard offer rates shall be designed so that they are essentially revenue neutral; that is, there will be no re-allocation of revenue responsibility between rate classes nor adoption of the rate design changes proposed in Citizens' original Unbundled Rates filing, with the following exceptions:

a. the Dusk-to-Dawn Lighting Service rate design will be modified to better reflect actual lighting energy usage by fixture type;
b. the demand ratchet for the Large Power Service Rates will be lowered to 80 percent.

The basis for the unbundled and standard offer rates shall be the cost of service presented in response to Staff data request BA-73.

The costs of Citizens' Valencia facilities shall be reflected in the revenue requirements underlying the rates for distribution service. If the Valencia facilities are no longer needed to support local transmission reliability, or other significant operating changes occur, Citizens will meet with Staff to determine if and how its rates should be revised to account for the changes that have occurred.

Citizens may file a revenue-neutral rate design proposal in 1999 based on more current customer load and usage data which reflects the following principles of cost allocation:

a. generation capacity costs will be allocated using the four (4) Coincident Peak (CP) and average method;
b. most distribution capacity costs will be allocated using class Non-Coincident Peaks (NCP);
c. load data will conform to the criteria described in the attached Appendix A.

Citizens' 1999 rate filing will also include the following principles:

a. a redistribution of costs among rate classes to achieve a movement of at least 50 percent of the way toward equalized rates of return;

b. the use of a rate phase-in process for all customer classes with annual rate changes over a multi-year period, if necessary, to insure that no customer (including zero-use) will experience a rate increase of more than 7 percent in any year;

c. the adoption of two-tier pricing for transmission and distribution services for Residential and Small General Service rates with a Customer Charge, Head Block and Tail Block.

d. an Unbundled Interruptible Service Rate based on removal of production demand, transmission, and sub-transmission-related costs from firm LGS rates;

e. a revenue-neutral re-design of the Large Power Service rate that allows recovery of lost revenue from known and expected conversions to 69 kV service; and

f. the equalization of Residential rates between Mohave and Santa Cruz counties.

g. the equalization of Small Commercial rates between Mohave and Santa Cruz counties.

Staff will accept the results of the cost of service study for rate design purposes, and the other rate principles above, if the study adheres to the above criteria. The load data should conform to the criteria described in the Appendix A attached to the Settlement Terms. (See attachment).

In conclusion, Staff believes the Settlement Terms are in the public interest and should be approved because the Company has agreed to unbundle its current tariffs and file a revenue neutral rate case with updated load data before proposing increases and decreases to certain rates and charges. On December 22, 1998, Residential Utility Consumer Office filed a letter stating that it would not object to the proposed tariffs based upon the functionalization of the Valencia generating facilities to either distribution or transmission service. The Company revised its tariffs in accordance with the Settlement Terms on December 8, 1998. Staff recommends that the December 8, 1998 tariff filing be approved to be used only as a customer information tariff. Staff further recommends that the effective date for the Company's unbundled tariffs be suspended until such time that the Commission has made a determination in the Company's stranded cost case (Docket No. E-1032C-98-0474). The proposed tariffs contain a provision for a Competitive Transition Charge (CTC) which is subject to a determination by the Commission. Staff further recommends that Citizens revise its December 8, 1998 filing at such time that the Commission issues a decision in Citizens' stranded cost filing.

Staff further recommends the Company's proposed System Benefits Charge with its request to include the CARE low income program expenditures as a part of its revenue neutral filing in 1999 be approved.

Ray T. Williamson

Ray T. Williamson
Acting Director
Utilities Division

RTW:JVW:djg/PAB

ORIGINATOR: John V. Wallace

BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
Commissioner - Chairman
RENZ D. JENNINGS
Commissioner
CARL J. KUNASEK
Commissioner

IN THE MATTER OF THE FILING BY CITIZENS UTILITIES COMPANY OF UNBUNDLED AND STANDARD OFFER SERVICE TARIFFS PURSUANT TO A.A.C. R14-2-1606	DOCKET NO. E-01032C-97-0774 DECISION NO._______________ ORDER

Open Meeting
December 30 and 31, 1998
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Citizens Utilities Company (Citizens, CUC or Company) is certified to provide electric service as a public service corporation in the State of Arizona.

2. On December 31, 1997, Citizens Utilities Company filed its unbundled and standard offer service tariffs pursuant to A.A.C. R14-2-1606. In this filing, the Company priced electric service elements such as transmission and distribution. The Company also filed standard offer tariffs which increase, decrease and change rates for various customer classes (residential, small general, etc.). CUC also submitted information and requested a system benefits charge.

3. Effective December 26, 1996, the Arizona Corporation Commission (Commission) adopted rules governing the parameters of retail electric competition. Pursuant to A.A.C. R14-2-1606(D), each incumbent utility must file Unbundled Service Tariffs to provide the following services to all eligible purchasers on a nondiscriminatory basis: Distribution service; Meter and meter reading service; Billing and collection service: Open access transmission service; Ancillary services; Information services; and Other ancillary services necessary for safe and reliable system operation. Pursuant to A.A.C. R14-2-1606(C), each incumbent utility may also file proposed tariffs to provide standard offer bundled service.

4. Decision No. 60575, dated January 14, 1998, suspended this filing until May 29, 1998. Decision No. 60910, dated May 22, 1998, suspended this filing until November 25, 1998. In a letter dated November 13, 1998, the Company agreed to delay the implementation of its Unbundled Services Tariffs and System Benefits Charge, which were filed on December 31, 1997 until December 10, 1998.

5. Staff's concern with the Company's unbundled tariffs as filed on December 31, 1997 was that they would result in step increases and decreases for certain standard offer customers and customers who choose competitive suppliers. These increases and decreases were primarily the result of higher fixed charges in the unbundled and standard offer tariffs than are in the Company's current tariffs.

6. As a result of discussions with Staff, the Company and Staff developed a Summary of Settlement Terms (Settlement Terms) dated November 30, 1998.

7. According to the Settlement Terms, for 1999, the Citizens' unbundled and standard offer rates shall be designed so that they are essentially revenue neutral; that is, there will be no re-allocation of revenue responsibility between rate classes nor adoption of the rate design changes proposed in Citizens' original Unbundled Rates filing, with the following exceptions:

a. the Dusk-to-Dawn Lighting Service rate design will be modified to better reflect actual lighting energy usage by fixture type;

b. the demand ratchet for the Large Power Service Rates will be lowered to 80 percent.

8. The Settlement Terms specify the basis for the unbundled and standard offer rates shall be the cost of service presented in response to Staff data request BA-73.

9. According to the Settlement Terms, the costs of Citizens' Valencia facilities shall be reflected in revenue requirements underlying the rates for distribution service. If the Valencia facilities are no longer needed to support local transmission reliability, or other significant operating changes occur, Citizens will meet with Staff to determine if and how its rates should be revised to account for the changes that have occurred.

10. The Settlement Terms state that Citizens may file a revenue-neutral rate design proposal in 1999 based on more current customer load and usage data which reflects the following principles of cost allocation:

a. generation capacity costs will be allocated using the four (4) Coincident Peak (CP) and average method;

b. most distribution capacity costs will be allocated using class Non-Coincident Peaks (NCP);

c. load data will conform to the criteria described in the attached Appendix A.

11. According to the Settlement Terms, Citizens' 1999 rate filing will also include the following principles:

a. a redistribution of costs among rate classes to achieve a movement of at least 50 percent of the way toward equalized rates of return;

b. the use of a rate phase-in process for all customer classes with annual rate changes over an appropriate multi-year period, if necessary, to insure that no customer (including zero-use) will experience a rate increase of more than 7 percent in any year;

c. the adoption of two-tier pricing for transmission and distribution services for Residential and Small General Service rates with a Customer Charge, Head Block and Tail Block.

d. an Unbundled Interruptible Service Rate based on removal of production demand, transmission, and sub-transmission-related costs from firm LGS rates;

. . .

. . .

e. a revenue-neutral re-design of the Large Power Service rate that allows recovery of lost revenue from known and expected conversions to 69 kV service; and

f. the equalization of Residential rates between Mohave and Santa Cruz counties.

g. the equalization of Small Commercial rates between Mohave and Santa Cruz counties.

12. Staff will accept the results of the cost of service study for rate design purposes, and the other rate principles above, if the study adheres to the above criteria. The load data should conform to the criteria described in the Appendix A attached to the Settlement Terms.

13. Staff believes the Settlement Terms are in the public interest and should be approved because the Company has agreed to unbundle its current tariffs and file a revenue neutral rate case with updated load data before proposing increases and decreases to certain rates and charges. The Company revised its tariffs in accordance with the Settlement Terms on December 8, 1998.

14. On December 22, 1998, Residential Utility Consumer Office filed a letter stating that it would not object to the proposed tariffs based upon the functionalization of the Valencia generating facilities to either distribution or transmission service.

15. Staff recommends that the December 8, 1998 tariff filing be approved to be used only as a customer information tariff.

16. Staff further recommends that the effective date for the Company's unbundled tariffs be suspended until such time that the Commission has made a determination in the Company's stranded cost case (Docket No. E-1032C-98-0474). The proposed tariffs contain a provision for a Competitive Transition Charge (CTC) which is subject to a determination by the Commission.

17. Staff further recommends that Citizens revise its December 8, 1998 filing at such time that the Commission issues a decision in Citizens' stranded cost filing.

. . .

18. Staff further recommends the Company's proposed System Benefits Charge with its request to include the CARE low income program expenditures be approved.

CONCLUSIONS OF LAW

1. CUC is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over CUC and over the subject matter of the application.

3. The Commission, having reviewed the Summary of Settlement Terms developed by Staff and CUC, the revised tariff pages in accordance with the Settlement Terms and Staff's Memorandum dated December 22, 1998, concludes that the Settlement Terms and revised tariffs are reasonable and equitable and are therefore in the public interest.

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ORDER

THEREFORE, IT IS ORDERED that the Settlement Terms and revised tariffs to be used only for customer information be and hereby are approved.

IT IS FURTHER ORDERED that the effective date for the Company's unbundled tariffs be suspended until such time that the Commission has made a determination in the Company's stranded cost case (Docket No. E-1032C-98-0474).

IT IS FURTHER ORDERED that Citizen's revise its December 8, 1998 filing at such time that the Commission issues a decision in Citizen's stranded cost filing (Docket No. E-1032C-98-0474).

IT IS FURTHER ORDERED that CUC's current tariffs shall be used as the standard offer tariffs.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

COMMISSIONER - CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, JACK ROSE, Executive Secretary of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this ______day of __________________1998.

JACK ROSE
Executive Secretary

DISSENT________________________________

RTW:JVW:djg/PAB

Appendix A

Guidelines For Updating Load Research

Since it is not possible for Citizens to update its load research program in a timely fashion, the Company needs to correct the deficiencies in its filed allocated cost of service study using surrogate load research data from other sources. The Company should use the alternate load research data in order to check the accuracy of its own data, and supplement it where appropriate. At a minimum, the Company should incorporate the following in its unbundled rate design:

1. The Company should prepare a statement on the applicability of the alternate load research data by comparing the load characteristics of the target classes, for instance, similar average customer size, similar climate (for classes with weather sensitive end uses such as air conditioning), and similar time of the system peak. The Company should also describe the load research accuracy and methods employed by the utility(ies) which developed the load research data.

2. The Company should begin with its own billing data (kWh. kW or kVA where applicable) and adjust the data if necessary to the time frame of the alternate data. The Company should adjust its billing data as appropriate, given its knowledge of the timing of its meter reading and billing. The Company should also explain how it estimated the consumption of non-metered classes. e.g. hours of darkness for street lighting classes.

3. The Company should apply the coincidence factors of the alternate load research data, or a ratio analysis, to develop estimates of class peak (NCP). system peak (CP) and maximum customer demands (MCD) at the customer level. The Company should adjust the coincidence factors or ratios as it deems appropriate based on billing data and on the older load research data, where class definitions have not changed.

4. The Company should adjust the CP, NCP and MCD for each class to the generator level by applying loss factors. The Company should state the source of the loss factors it utilizes. Next. the sum of the CP's should be compared to the actual system monthly peaks, and adjusted if necessary on a reasonable basis (excluding deterministic loads such as hourly metered classes and street lighting classes.)

5. The Company should then compare the resulting class allocations to those in its initial filing. The Company should state for which classes it will use the allocators based on the surrogate data.